Corrected Transcript

01-Jun-2018

Spirit AeroSystems Holdings, Inc. (SPR)

Bernstein Strategic Decisions CEO Conference

CORPORATE PARTICIPANTS

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

MANAGEMENT DISCUSSION SECTION

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

So, good morning. I'm Doug Harned, Bernstein's Aerospace & Defense analyst, and I'm very pleased to have with us again, Tom Gentile, the CEO of Spirit AeroSystems. We're going to do a fireside chat format, but Tom is going to talk a little bit first about a number of the broader things around Spirit.

And so, I'll turn it over to Tom.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

Well, thank you very much, Doug. And I would just remind everybody that normal Safe Harbor comments apply in terms of forward-looking statements. But what I thought I would do is just give everybody an update in terms of Spirit and what happened since the last earnings call we had back a few weeks ago. And just to give everybody a perspective, wanted to – for those of you who don't know us well just give you a little bit of an overview of Spirit and an outline of what our strategy is that we have communicated, give an update on the recovery, particularly with regard to Boeing 737 and Airbus A350; talk about the acquisition we announced at the last earnings call of Asco Industries from Belgium and the integration planning for that is well underway. We talked about a new debt issue and I'm very pleased to say that that's now complete. We raised $1.3 billion of new long-term debt and extended our short-term facilities.

We also talked about an accelerated share repurchase. We have launched that now, it's in the market. And so, we'll talk a little bit about our capital deployment strategy and some of the things that we're doing to continue to build for growth. And then, I'll just wrap up with a summary of our 2018 guidance, which is not changing. But for those of you who aren't familiar with us, we are a structures business. We happen to be the largest structures business in the world, mostly commercial today about 95% of our business and we are on all of the platforms for Boeing and Airbus. So of all the 13,000 aircraft that they have in their backlog, we have work packages on all of them.

Our backlog today is $47 billion, which is almost seven years of production. And the way we look at our business is in terms of the different structural components of an aircraft, so about half is fuselage and then the rest is split evenly between wing and propulsion, including things like pylons and nacelles thrust reversers. As I mentioned, 95% of our business is commercial, but we do have 5% which is defense and we're on some very good platforms. So we are on the tanker which is a version of the Boeing 767, the P-8 versus of the Boeing 737, but we're one of seven suppliers on the B-21 and we make that fuselage for Sikorsky on the CH-53K, so its 5% today of our business and it's growing.

In terms of our strategy, last year we had an Investor Day in September and we outlined that our vision is really to be the leading aerostructures business in the world, both in terms of large and small structures, composite and metallic, commercial and military. It's a $55 billion annual market and it's one where we think we can compete very effectively.

In terms of where we want to compete, of course, we want to continue growing with our two largest customers Boeing and Airbus, but we've also said we want to make fabrication in defense, both billion dollar businesses. And we are on our way to do that. In terms of how we want to compete, our supply chain is incredibly important to us, it represents about two-thirds of our cost and our suppliers are critical to our success, but we're also focusing on the next generation of innovation with a very aggressive research and development budget, we're digitizing our factories and of course, we're working on building our talents and building a world class team. And the way we measure ourselves is organic growth, we also are looking at our margins and we want to maintain and expand those over time and then cash flow, we've outlined 7% to 9% of our sales as a free cash flow conversion target going forward. And then of course, we're focused very much on total shareholder return in the form of a dividend and share repurchases.

Now in terms of Q1 at the earnings call, we outlined that the transition to the higher rates of production both on the Airbus A350 and the Boeing 737 in particular, have created some short-term issues. And so, in Q1, our EPS was lower than we had planned, but cash was actually very strong and revenue was solid, particularly as the rates go up. But what we outlined is that, the transition to the MAX and the increase in the rate, in particular, created incremental cost in the form of over time, surge resources and expedited freight. So we've put in place a recovery plan to get back on to schedule and to get the costs down, and what I'm pleased to report is that recovery plan is on track.

We are very close to being back to schedule with the Boeing 737, that will happen in the next couple of weeks, and as that happens, the surge resources are going away, expedited freight will go away and we will be building up the sufficient buffer, and same thing on the Airbus A350. We had some weather disruptions earlier in the year, which caused us to switch from sea freight to air freight, because the panels are very large for the Section 15 that we build, the middle fuselage section of the A350.

But we're back onto schedule now. We're shipping by sea again and so, that expedited freight is going away. So we're very comfortable with where we are on our recovery plan. There'll still be some incremental cost in Q2, because we were catching up, but the deliveries will be very solid and we're back on schedule with both Boeing and Airbus, we feel very good about that.

The other thing we announced in the Q1 earnings call was the acquisition of Asco Industries and we're in the process of working on getting that close, getting all the regulatory approvals, very excited about this business, a Belgium company, family-owned since 1954. It's a very advanced sophisticated machining organization, they specialized in hard metal five-axis machining, they make a lot of wing components for Airbus, but also for military customers like Lockheed and they have significant work packages with Bombardier and Embraer. So, it's a very nice fit for us, we expect this to close in Q3 in the September timeframe as we work through the regulatory approvals.

What we really liked about this business, it fits strategically with our objectives. It gives us more Airbus content. That's about 50% Airbus. It gives us more military content, particularly gets us on the F-35 platform, and it also gives us more fabrication capability. They've got a good commercial organization. They've won work with Airbus, with Bombardier, with Embraer. It's a very solid organization that fits in nicely. The multiple we paid for was 9.3 times EBITDA, before synergies and 7.6 times after synergies, so we've got a good financial deal. And then operationally, it has four sites, they're all highly automated, very efficient scale sites. It will fit neatly into our operations. So financially, strategically, operationally, this is a very good deal for us.

The other thing is it really gave us the opportunity to look at refinancing our debt. The $650 million purchase price, we're going to finance that with that and we're going to take the opportunity to lower our overall cost of debt and extend our maturities. So, last week, we in fact issued $1.3 billion of new debt. We use some of that to pay off some higher cost debt to fund the acquisition and also to just help fund an accelerated share repurchase and that accelerated share repurchase is going to be $725 million, but the new debt structure will bring our leverage more in line with the industry average of about two times from where it is today at one times.

As I mentioned, the $725 million share repurchase will bring our total share repurchases for the year up to $800 million. That is already launched, it's in the market. And so that was something else that we were able to accomplish since the earnings call. And so in combination with our dividend and the share repurchase for the third year in a row, we will deliver more than 100% of our free cash flow back to shareholders in the form of that share repurchase and debt.

So, we again feel very good about that and it reflects the confidence we have in our long-term outlook. As we continue to grow for the future, a lot of significant accomplishments, we delivered our 10,000 fuselage to Boeing for the Boeing 737, took us 52 years. At the current rate of production though, we would deliver the next 10,000 in just 15 years, so things are growing. We've put in place the new global logistics center on our campus in Wichita. That will enable us to consolidate 500,000 square feet into 150,000 square feet and as rates continue to go up, it opens up more space in our campus for those rates.

We're growing our fabrication business. We launched our 5-axis Center of Excellence in Wichita, our 3-axis and 4-axis Center of Excellence in Oklahoma and that is substantially improving our fabrication capability. On the defense side, we delivered our 5th Test Article on the CH-53K to Sikorsky, the 6th goes out in mid-June and then we will start our low rate initial production. So, that program is starting to ramp up. And then with our colleagues at Wichita State University, we launched the new research and development effort and that will help us develop the next generation of ideas for architecture, material and manufacturing processes for aircraft to help us win work on the next generation of programs.

So we were also very excited about that. In terms of our guidance, it remains the same, unchanged, $7.1 billion to $7.2 billion on revenue, $6.25 to $6.50 per share in EPS, 21% to 22% effective tax rate after tax reform and with free cash flow at $550 million to $600 million. We've got a lot of work to do of course, but we've remain with that guidance for the remainder of the year.

So with that, Doug maybe we can just do some questions.

QUESTION AND ANSWER SECTION

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Great. And if you all have any questions please, feel free to use the cards and we can pass this forward, thanks. So, Tom you talked about the issues around the ramp in the Boeing 737 MAX and that was clearly something that concerned a lot of people when this first – you first announced that you're maintaining guidance. Could you talk about how that works? In other words, you've discussed how you're resolving – you have resolved a lot of these issues and brought the rate up. When you look at the year as a whole, how do you make up for the shortfall in the beginning of the year to be able to maintain your guidance?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. So from an EPS perspective, as I mentioned, the incremental cost that we incurred during the first quarter and into the second quarter were related to things like more over time incremental resources, contractors to help us get caught up, and then also expedited freight; and that happened on both Boeing 737 and Airbus A350. As we are back onto schedule, those costs will go away. We can get back to regular levels of over time, the surge resources go away and we can also eliminate the expedited freight.

In addition, we've stretched ourselves as a team to tighten our belts and reduce discretionary costs, reduce our non-labor costs, reduce our indirect costs so that we can recover. So, we have operational plans to recover to guidance over the course of the year, but there's always execution risk in that. The other thing what we're doing obviously is this accelerating share repurchase, will give us some additional cushion to help us ensure that we can reach our EPS guidance for the year.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

But from a cash standpoint, you're staying with your cash numbers as well. So that means that we should expect some even stronger performance in the back half of the year to make up for the...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, on cash, the thing is – one thing that helps these deliveries are going up as rates go up on all the big programs. So that's one thing that helps. The other thing is on capital expenditure, we guided at the beginning of year $350 million – $300 million to $350 million. We're going to push to be at the low end of that range by sharpening our pencil, spreading things out over longer periods of time, deferring some of the less priority projects, but really a focus on capital expenditure and then also on working capital. So, again pushing very hard on inventory levels, accounts payable and accounts receivable.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

So when I think of the history of Spirit, you've – Spirit's done a number of quite a few rate increases over time and it's all been done in the same footprint...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Yes.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

...which has been pretty amazing, I think, to many of us. If you look forward, Boeing is clearly exploring possible higher rates on the MAX. Where do you go from here? If you're going to go to 57 a month, is there the room that Boeing goes higher to continue to move that up?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

The answer is yes. There is room on the campus. It's a big campus. We've got our 12 million square feet of manufacturing space. But it's full. But one of the things that we're doing for example, I mentioned that Global Digital Logistics Center. So that's going to be a state-of-the-art center that we'll be able to consolidate 500,000 square feet of warehouse space into 150,000 square feet, and that opens up a lot of room on the campus. Another thing that opens up room is with the Asco acquisition, for example, we'll be able to do some more fabrication at those facilities that could move out of our facilities in Wichita's create more space for rate. So, if Boeing does decide to go up in rate, we certainly have the room in terms of the infrastructure to accommodate it.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And then, when you think back over the many rate increases you've had on the Boeing 737 over time, can you talk about what's different about this one, why this one turned out to be harder, obviously the MAX just rolled in here, but can you give us a sense of, first, why it's more challenging and then second, how you have confidence that when you get done, you're going to be performing like you have on these past rate increases [indiscernible] (00:14:29)?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, there are two things that we'd – not only had the rate increase, you had the conversion in the models from the NG to the MAX. And so you have five or six different versions of the NG that, the Boeing 700, the 800, the 900, the freighter, the P-8, the BBJ and now you have the MAX. And so, you're really doing a lot of complex changing and so you have to learn how to produce the MAX. Last year, we produced the first 75 MAXs and we were learning how to do it.

This year, we're obviously producing a lot more. We're further down the learning curve and that is more streamlined, so that was one element of it, but it's really about the supply chains, they were going through the same issues and they in some cases were struggling and we've – a handful of our 600 suppliers, there were about 15 that were struggling. And so, parts weren't arriving where they should have in the line. We had more travelled work, more cost to install that further down the line and that created delays. And so those were some of the challenges that we were experiencing that made the transition a little bit more difficult.

The other thing is I would say that's different about this rate break versus previous ones is, we're now at 52 per month versus when we switched over from the Classic to the NG, it was about 15 a month There's just very little margin for error. And when something happens, we're working pretty much 24/7, there's not a lot of surge capacity to catch up.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

[indiscernible] (00:15:56) what we're trying to build back into the system is that surge capacity and effectively to catch up over these last couple of months, we've been building at an effective rate of 57, and so that gives us some confidence for next year when we actually go to that rate break is as that we can do it.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

So the 57 a month, so operating at 57 today, it will be a little different than the other way you do it at 57 next year.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Absolutely. Well, this year we did it with overtime and surge resources.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Next year we'll be at normal production levels.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Then on – if you look at the supply chain today, I mean that was clearly is some of the issues you had were in the supply chain. How does it look right now? I mean, are there areas that are still issues or does it appear to be pretty much resolved across the board in terms of your rate increase?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well – yeah, it's much better and when we look at our suppliers, the ones that have had some difficulties and challenges and disruptions, we put in place plans [ph] we call them get plans (00:16:55). And everybody is tracking to their get to green plant. We have many fewer shortages, the parts are flowing better, but we're keeping a constant eye on it. We have SWAT teams out at some of the bigger suppliers where there have been challenges and we're working on it. One of the things that we're doing for example is off-loading or on-loading work from suppliers if they're challenged in the short term on capacity. That work will go back to them once they get the people or the equipment up online and running, but – and that's one of the ways we've mitigated the issue is by spreading out the work to more suppliers including ourselves.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

I see. And then when you do the Asco, when you've – you've got Asco in-house and you're integrating it. And how does that change the way that you'll think about your supply chain? Are you going to be looking at more vertical integration, how will you use those capabilities?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, we use it in a couple of different ways. One is vertical integration. If there's an opportunity for us to lower costs by doing it internally, we certainly will consider that. The other thing though is we'll look at opportunities to address short-term challenges or disruptions. We called it Blue Streak. And so if a supplier has a problem and we need quickly to get it part, we can Blue Streak it in our capabilities, and Asco has some very sophisticated capabilities, particularly for a 5-axis machining, they can also do processing.

In addition we're looking at starting to do more third-party sales of fabricated parts. It could be to other Tier-1s, it could be to defense primes, it could be the Airbus and Boeing, Bombardier or Embraer or even business jet or regional jet providers. So it opens up a lot of opportunities. And if we think about the next generation of aircraft for Boeing and Airbus, they may decide to insource some of the Tier-1 work. And if they do that, then we will try to compete on Tier-2 work. And so that's another opportunity that the acquisition of Asco will provide us.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

And then on the new airplanes as you all know, Boeing is pushing forward, trying to make a decision on the NMA, the New Midsize Aircraft, how do you think about that? Have you been working with Boeing on this? Is this an area that you see as a big opportunity going forward? Right. What do you think about NMA?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, NMA, we read about it, and we understand a lot about it. It appears that there is a lot of demand in that segment of the market in terms of passenger size and range. And so Boeing is making the evaluation about whether they want to launch that aircraft. And so we are focused on developing how could we contribute to that. So, what type of ideas can we bring in terms of new architectures, new materials, new manufacturing processes that could add value to a next generation of aircraft. And we are proactively reaching out to Boeing and talking about those ideas. They're still very early in the process. They haven't really engaged us yet officially on it, but in the future, we will try to compete on it. And if we can come up with a mutually acceptable plan, then we would obviously be excited to be part of it.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Because it seems like given the composite structural design that Spirit will be pretty well-positioned based on your Boeing 787 experience.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Right. We have a lot of experience with fabrication of large, complex structures and we've been continuing to advance those ideas. So, this year for example, we said early at our Q1 earnings call is that we're going to spend more on R&D than we have in the past, precisely to accelerate some of those ideas, so that if Boeing approaches us that we can have those ideas ready to present to them for the next generation aircraft.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah. On the Boeing 777, so we're going through this transition period from the Boeing 777 to the Boeing 777X, so rate comes down now essentially and then you're going to see that Boeing 777X coming out in – hopefully in 2020 for first deliveries.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

How does that affect Spirit both in terms of near-term cash flow as that Boeing 777 rate comes down and then how different will it be participating on the Boeing 777X?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. So, well, first of all, the rate has come down on Boeing 777 and that's created a headwind for us. So, if you go back a couple of years ago, they were at 8.3 aircraft per month, then it went down to 7.2, then 5, and now really they're effectively at about 3.5 is where they are. And so that's a mature program. And so the reduction in rate definitely is a headwind in terms of reduced revenue and also reduced profit. So we've had to offset that.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

But you've already been operating at that?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Now we are, yes.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

It's just – you're operating at 3.5.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

3.5 this year.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Effectively.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Okay. So we're delivering the first articles now for Boeing 777X that is going very well. And I would say once that rate starts to go back up, that will be very good news for us, because that's a good program. And there's a lot of work to do still on it. But as with all of our programs with Boeing, we have life of program contracts including derivatives. So, we have the same work scope on the Boeing 777X that we had on the Boeing 700 – the 300ER.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

So it's not a lot of difference.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

No. but it's just – it's just like the MAX and the NG, there's differences in terms of the dimensions. The engines are bigger diameter...

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

... heavier, so heavier gauge. Some of the materials change, some new parts, some reduction of parts. But we have the same scope of work package that we had on this Boeing 777 300ER.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

So, I mean should we expect to see some headwinds when you head into that transition and you're taking the Boeing 777X up?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, there'll be a learning curve to get used to it.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

The difference is we're going to be at five and seven aircraft per month as opposed to 52.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

So, that's one of the big differences in that transition. So...

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

...but there's always a learning curve as you make a transition to a new model like that.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

On the other side of this, we're headed up to 14 a month on the Boeing 787.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Yeah. That's well underway and it'll start at the beginning of next year.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

What is that from an investment standpoint? What does that mean for you in terms of going to that – from 12 a month up to 14 a month?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, there is – the infrastructure is already there. We already have the building, so there was no bricks and mortar. We already had sufficient capacity in our autoclaves, which is a big investment. There's some additional capital investment for things like trim and drill and fastening and those have already been placed and ordered and that will be arriving in time to go up to 14 rate. But all of that is well underway and on track for the rate 14 that will take place in early 2019.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

And then, so, when you look at the Boeing 787, I think correct me if I'm wrong, but it's fair to say you've been sort of moving down on costs kind of with price. I mean it's sort of in – and so it hasn't been by itself, the Boeing 787 hasn't been a big cash margin program for you.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Well, it's kind of a zero margin program.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Because, we're in a forward loss position.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Yeah. So but I'm thinking also in terms of cash margin.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Right.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

So when you look at that going forward, you have more step downs I assume...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Yes.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

...but you have a rate increase, which should be helpful.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Right.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

And then you've got the Dash 9 and the Dash 10 become really the dominant airplanes that you're building. How should we think about this evolution in terms of what it means for both cash margin and booked margin?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Obviously the forward loss position here, right, bookings ...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

So, we've, we've laid out our forward loss position through line unit 1405, which basically will as the current rates have projected of production to be about 2022 and so that's all been laid out. We are working very actively with Boeing on reducing the cost. And there is a – when we announced the deal last year, we said that there's a joint incentive for both of us to reduce cost. So they benefit and we benefit. And so we're making – continuing to make progress. There's still a very good learning curve on that program and so our goal is to get it down to the point where it's a profitable program in the future, but it won't – that won't happen until after the line unit 1405.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

But profitable – what about profitable from a cash standpoint, right? I appreciate that [ph] any working off (00:26:04) the forward loss, but – and how should we think about it is as a contributor of cash?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. Well, again the, the position is that the cost is higher than the price and that's why we took the forward loss. So we have work to do to get the cost down, so that is going to be profitable from a cash basis as well.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Does it mean that presumably it's before the – it happens earlier than the 1405 number right?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, that's you know...

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yes.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

The goal would be that. Yes.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And I'm assuming that the going to 14 a month is helpful.

Thomas C. Gentile A
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

It is. And if you remember in the fourth quarter, we announced that because of the fixed cost absorption to go into 14 a month, there was a reduction in the forward loss of about $40 million at that time.

Douglas Stuart Harned Q
Analyst, Sanford C. Bernstein & Co. LLC

Yeah.

Thomas C. Gentile A
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

And that get back uplift in fourth quarter of last year.

Douglas Stuart Harned Q
Analyst, Sanford C. Bernstein & Co. LLC

Then if I roll all of this together for Boeing, last summer you completed your agreement with Boeing, which pretty much lays out kind of a five-year look where you know what pricing is and at that time, you took your expectations for cash as a percent of revenues from 6% to 8% up to 7% to 9%. How did you get there? In other words, what main things look better and give you more confidence in cash generation once you'd completed those agreements with Boeing?

Thomas C. Gentile A
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

Right. Well, it gave us more certainty. I mean we were already at the 7% level anyway. And with the Boeing deal, we had more certainty over a five-year outlook. And so that's why we were able confidently to raise it. The other thing is we've been working a lot on our own supply chain initiatives. And that was one of the reasons we've said that after the deal, we could offset the productivity discounts and the price step-downs by continuing to drive productivity. Two-thirds of our cost is in our supply chain and we've been working very closely with our suppliers to bring those costs down to make them globally competitive.

Douglas Stuart Harned Q
Analyst, Sanford C. Bernstein & Co. LLC

Well, if we switch over to the Airbus A350, you talked a little bit about the disruptions getting that back on track. And is that primarily – I mean you had the weather issues, but maybe you can talk a little bit more about where you stand there with respect to the supply chain and having the kind of buffer to make sure you don't miss deliveries to Airbus right either.

Thomas C. Gentile A
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

So, with the Airbus A350, again as rates were going up over the last couple of years, we were pretty stretched and again working 24/7 with not a lot of margin for error. And so when we had a couple of weather days where they declared a state of emergency in the state of North Carolina, we lost production. We had a shift from sea shipments to air shipments. And because the panels are so big, they're each about 60 feet long. And when you put them into the barrel, it's 21 feet in diameter. So it's quite large sections. They have to ship by [indiscernible] (00:29:05), which is...

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

...quite expensive.

So the solution to that is really to build up more of a buffer. So we had enough capital to produce, assuming full utilization of the equipment. But when you get the disruptions like weather days, you don't operate at full utilization. So what we've done is, we've put in place some more capital that was part of our budget for in this year that enables us to build up a buffer. And what we are doing right now is we're on schedule with Airbus, but we're actually building a little bit ahead of them, and as they get into the summer months, they usually have a big – they do every year have a big shutdown during August, so we will actually be able to build up a buffer. So, as we head into the storm season next year, we'll have a buffer that we've never had before, so that we can weather the storm a little bit better.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

No pun intended.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And then also on the Airbus, one of the things that – I've always tried to understand here is when you look at the Prestwick and wing systems, the margins there have always been a little bit lower than some of the U.S. operations. Can you talk about what the differences are working in the UK, in the Prestwick facility? What's the potential to take margins up, can you actually get margins up to some of the levels you can get it to in Wichita for example?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. We can certainly continue to improve that. The great thing about Prestwick is they have a fantastic workforce. It's experienced, many of them have qualified apprenticeship, credentials, attrition is very low and when we go to hire workers, we recently put out an advertisement to hire 50 additional workers as rates continued to go up. We had 450 highly qualified applicants. So there are some great aspects of Prestwick.

But what we can do is same sort of levers that we can pull in Wichita continue to focus on supply chain where there's a lot of cost, continue to drive automation, I'll give you – and then also continue to incorporate new technology. One example, we had a spoiler that we make for the Airbus A320 wing. For years that had been manufactured in Asia, because of low cost of production. We actually on the next generation of it used a different methodology, it's composite and we use a resin infusion technology and it's going to be highly automated.

We're actually bringing it back from Asia to Prestwick and lowering the costs substantially. And so it's those kinds of initiatives which will enable us to make Prestwick more profitable and continue to be a very core source of supply for Airbus.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Because at Airbus, as Airbus looks at the neo, there are discussions today that I've heard [indiscernible] (00:31:45) talked about going to 70 a month potentially. I've heard even 75. So when you look at those rate increases, can you get comfortable with those? In other words how much lead time do you need before you could move...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, there's always a certain amount of lead time. It's little bit less for our Airbus scope of work than it is for our Boeing scope of work, because – just different. We are much more deeply involved in fabrication with Boeing. So, the lead time is less for Airbus, but we do the studies constantly, playing off the different scenarios and we're confident that the facilities – we have a very big 100-acre facility in Prestwick. And so again if Airbus decides to go up in rate we certainly have the facilities to do it and we will put in place the capital and the tooling to make it possible.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

As Airbus has gone from the ceo to the neo. Has that changed much in in the things that you're doing for them on the Airbus A320?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, there is differences, and so again, it's the same learning curve, because the ceo parts are different from the neo parts, and we did make a few mistakes where we drilled the holes in the wrong place or installed the wrong part. And so what we've done is similar to Boeing 737 there's color coding. So for example all the parts for the ceo are in a red box and all the parts for the neo are in a yellow box on the floor. So because the units are coming down the same line and some of them are ceo and some of them are neo. And so we've had to develop these processes to make sure we don't – and again that's a learning process, but we're working our way through it and it's been very successful.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

I mean is that true for the MAX and NG too?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Yes. There's different parts, so you have to be very careful.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

You're putting them down the same line?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Same line.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

I think that's one of the great efficiencies at Wichita in our plant too is that we can put down the same line six different versions of the NG and eventually there'll be four different versions of the MAX.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Well, that's what actually amazed me when you started doing P-8s there, that you were able to run the P-8s down...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

[indiscernible] (00:33:54)?

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah. And...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

We do have one station where it's unique to the P-8, but other than that they go through the same line.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah. And you could do that without disrupting the performance of those operations.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Yeah.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

I found it surprising that you could do that.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, it's one of the things I think Spirit operations is one of our strong points and the operations team that we have in Wichita in particular does an outstanding job and this has been a challenging rate break and model mix change, but they are performing well and as I said we're practically back on schedule with Boeing, took a lot of effort and our goal is to stay there now.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Now, when you look at working with Boeing and Airbus, how different is it working with the two companies?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, they're both very demanding. They have high expectations, very focused on quality and delivery and they're very customer-focused to their own airline customers, but that said they have different styles, different priorities, there are different metrics that they use, different processes, different ways they interact with us, they have different operating rhythms, so there's a lot of differences. It took us a while to learn those at Airbus because obviously coming out of Boeing there was much more familiarity with Boeing and the relationship is broader and deeper, but obviously we're learning the Airbus methodologies and working with them. Both of them again are demanding, have high expectations and focus a lot on quality, safety, but they do it in different ways.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Now, in Boeing – and for you it may be a little different than a lot of those suppliers because of these long-term contracts, but you have the Partnering for Success initiative at Boeing and then you have the SCOPE...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

SCOPE+.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Yeah, SCOPE+ initiatives at Airbus. Are these initiatives things that for you because you have long-term agreements with both companies are pretty much resolved in how you work with them or are they initiatives that you continue to sort of put under pressure and trying to deal with?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, the airline industry, the global aviation industry is incredibly competitive and price-sensitive. I mean you and I as flyers will switch airlines for $100 on ticket. And so there's a lot of pressure on airlines and that passes down to the OEMs and of course it cascades to supply chain. So, there's always pressure to be more productive and to drive cost down. And so even though we have long-term contracts and life of program contracts it doesn't make us immune to having to drive productivity.

Boeing expects it, Airbus expects it. And so, we work to deliver it. The agreement last year with Boeing for example included productivity discounts in Boeing 737 as rates go up. There's price step-downs on the Airbus A350 and on the Boeing A787. So, those are just part of doing business in this industry. We have to constantly drive productivity, in order to meet the expectations of both Boeing and Airbus.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Are you comfortable in the ability to maintain margin levels?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, I've always said in this industry, you have to run very fast just to stay in the same place. You have escalation in material and labor, you have productivity discounts and price step-downs. And so to offset that you've got to work very hard all the time. And so we're confident we can do it. We have a lot of initiatives with our supply chain. We have initiatives with our internal productivity, with our non-labor costs and so we are driving that. And the goal is to maintain the margins at the same levels despite all of those escalations in material and labor and challenges on productivity.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Now, one of those escalations you heard about a little yesterday with the tariffs...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Yes.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

... on – [indiscernible] (00:37:43) tariffs on aluminum. How does that affect you, the tariffs on aluminum and steel, what kind of impact does that have on steel?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, steel is not a big issue for us. We have just a little bit of steel, obviously aluminum is a much bigger issue for us because we consume a lot of aluminum. That said, a lot of the aluminum we buy is through the buying consortiums that Boeing and Airbus have. So Boeing for example is TMX.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

TMX.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

So we buy a lot of aluminum through that. A lot of the aluminum we buy outside of that does come from the U.S. and Canada. But now Canada potentially is subject to these tariffs. So the short answer is we don't know fully what the impact is, but even in the worst case it's not a material number...

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

... for a company of our size, but we're watching it very carefully to see how it could impact us.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Well, that's what I wanted because if you look at a Boeing 737 as an example and you figure out the value of aerospace grade aluminum in the airplane, it's a very, very tiny percentage of the value of the airplane.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Exactly.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

But as you move down the supply chain people who are in structures and are dependent on aluminum, it becomes bigger and bigger. So, for you it would – the percentage would be bigger than it would be for Boeing. And you will have suppliers I would expect that might even be more serious. How do you see the tariff issue...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Right.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

... as you kind of go down [indiscernible] (00:39:08) ...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Again at this point – because we buy a lot of it through Boeing and TMX.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

And they have a lot of buying power. So that's one aspect of it. A lot of what we buy does come from the U.S. Canada [indiscernible] (00:39:21) so we don't know the exact impact. But even if we took the worst case, it's not material.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Not material. Okay. Well, if we switch over to defense, you're talking about 5% today. Where do you think – knowing the programs you have, if you go out five years from now, what percentage do you think defense will be?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, we'd like to get it over 15%. That's the target. So in this more...

[indiscernible] (00:39:48)

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

... kind of mid-20s.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Okay. So once CH-53K is at rates, once B21 is producing with the tanker continuing to produce and the P-8, those are all great programs. And now we are on F-35 with the acquisition of Asco. Asco makes the [indiscernible] (00:40:08) bulkhead for that. So we're confident that there's opportunities and we have relationships now on some of the top programs. So we're on the B-21, we're in the CH-53K, we now have some work on F-35, and we're on the tanker. Those give us great beachheads and continue to expand our defense work.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And the CH-53K, can you describe what that ramp looks like right now? I mean it just started. I mean we had the first delivery.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right now we're still in test article phase. And so there's one more test article that has to be delivered that will be done in mid-June. Then we go into low rate internal production. So we don't expect it to ramp until a few years out yet. That said, the Marines have said they want to order 200 of the CH-53K. And that's a pretty big buy. And then in addition to that they're looking at foreign military sales. In fact, over at the Berlin Air Show recently, the CH-53K was there and did a demonstration. We were there on hand to see it. And that could also be a big order. So in addition to the marine orders and the foreign military sales that looks like it will be a great program for many years.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And Lockheed Martin talked about that here.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Okay.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

[indiscernible] (00:41:22) goal of making that happen. Now, on the B-21, I mean it was obviously a very big deal when you got significant content on that, I know there's not much you can say about it.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

But can you give us a sense of kind of how important that program is to reaching your goals – your longer-term goals in percent terms?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. Well, you're right, it's a classified program, there isn't much we can say, but we are one of seven suppliers that were selected by the Air Force to be a supplier on the B-21. And as you know publicly, the Air Force has indicated they want to order eventually 100 and it will be a core part of the fleet going forward.

And when you look at the nuclear triad and you look at what the bomber fleet is today that's capable of delivering nuclear weapons, the B-52 is still in operation. So the need for a new bomber is very clear and we're very proud to be on that program.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And then, just in terms of investment, I mean is this a substantial investment for you all getting – what's the timing of when – I would imagine there's some CapEx associated with this and...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

There is and all of that capital expenditure is built into our current guidance and in our future outlook and it's right on track.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. What other defense opportunities do you see?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, there is always an opportunity to expand on the programs that we currently serve. So whether it's F-35, whether it is CH-53K or even B-21, those are all natural opportunities because we're already on them.

In addition, we'll continue to look at the other programs. There is a new drone program that's a tanker for carrier-based operation.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

MQ-25.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc. A

Yes.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

Yeah.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc. A

There is the trainer, those are other programs that we would have interest on and we'll look for opportunities, more on maybe the fabrication side of things.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

Now, is this something that you have been engaging more with the potential customers on. I mean several years ago, I mean defense was not that important. When Larry Lawson certainly came in, coming from Lockheed Martin, right. He talked a lot about, wow, we have a low cost aerostructures capability here that can play well.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc. A

Right. Definitely having a lot more discussions with all the primes in terms of how we can support them and take our commercial capabilities and translate those into military programs.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

Okay.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc. A

We think there's a significant opportunity for us to add value doing that.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

Then going back to Asco, can you talk about – I thought the deal was very interesting. It seemed – it appeared there's a lot of press that you were very interested in GKN is an example. When you look at Asco, why Asco versus maybe other opportunities that might have been out there?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Well, we've looked at virtually every structures business that's come to market or been considered to come to market. And our focus is we've been very deliberate and very discerning. And our focus is, does it meet our strategic criteria. In other words, does it add Airbus content, military content, fabrication capability. Asco met all of those. Financially, does it work? Can we get it for a value which we think is fair and appropriate in today's market? And Asco at 9.3 times before synergies, 7.6 times after synergies, met those criteria. And then operationally, is it well-run and is it easy for us to integrate? And with four facilities, all of which have scale and are highly automated and efficient, Asco met that criteria as well. So, other properties that we've looked at or other assets haven't met either those strategic, those financial, or those operational criteria. And so we passed on them.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. And can you just refresh us on the size of the synergies, the cost synergies and what you're looking at?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

So, Asco is about $400 million annually of sales, the synergies that we've identified are $15 million, so call it 4%, which is really at the low end of the range for deals of this size in our sector and that means that we've been very conservative and we're very confident we can deliver those really by the end of 2019, and it's things that we are very good at. So for example, supply chain is going to be a significant part of that synergies, there's some corporate overhead that's duplicate. We can fill up their operating facilities. There's different ways that we can look at, the way they operate their equipment. So, we've already identified the buckets that we can get those synergies $15 million, and that would get the multiple post synergies to 7.6 times EBITDA.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Then are there some things that – and I guess in terms of your supply chain, so I think Asco brings another element to this. But if you're looking to bring down costs in your supply chain over time, how do you approach that? I am assuming that on the one hand you can work with Boeing and Airbus as leverage with Tier 2 and Tier 3 suppliers, you now have Asco, which essentially maybe can compete in some areas. How do you think about proceeding to get supplier cost in?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. So, we have a very structured process to do that and it's got six pillars. So, we start with what we call our clean sheet process, we reverse engineer every part that we buy – and we've done over 70,000 of those, to identify what this should cost and then we have a strategic sourcing program where we work with our suppliers to get to that should cost. And this is a gate process with deliverables, so there are five different gates, there's more than 200 deliverables and we have dashboards and operating rhythms to work with the suppliers to get to that should-cost. And then we have something we call supplier support which is we work with them to either help them buy material at lower rates, do processing, do engineering, work with them on logistics to get the cost to the should-cost.

Now, if they can't get to that level, one of the options is we can insource it. And so we've created a three- and four-axis center of excellence in Oklahoma and a five-axis center of excellence in Wichita as well as a low-cost assembly center of excellence in Malaysia and so we can insource work to get the cost down, so that's another tool that we have. Now, if we can't insource it to get it to the should-cost we do what we call a hypercompetitive negotiation.

Some people call it a [ph] hotel bid (00:48:02). We'll identify $200 million or $300 million worth of supply and then we'll bring in 20 or 30 suppliers and over the course of a week [ph] bid off (00:48:12) and by the end of the week we'll award the work. And that's been very successful for us to get globally competitive rates. And then when we have to transfer work again we have a very sophisticated rigorous transfer of work methodology, and it has 8 gates and about 30 deliverables, and so we transfer the work. So, the combination of those six things, the should-cost, the strategic sourcing process, the supplier support, the insourcing, the hypercompetitive negotiations to the transfer of work give us the ability to drive to globally competitive supply chain rates.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

If we pull all this together and go back to your expectation of delivering 7% to 9% of revenues in cash each year, as your revenues rise, what do you see that would be a risk to that range both on the downside and on the upside? What are things you might worry about, what are the things that could give you potentially go higher than the 9%?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. Well, the thing that caused us the most disruption recently in our supply chain is not having parts. And so that's always an issue particularly as rates are going up, is that a supplier ends up for whatever reason because of lack of people or equipment or something else, IT changes or weather that we can't get our parts. And so that could create a significant amount of disruption. On the upside is if we can continue to drive our internal costs down and get our supply chain even more competitive that could potentially provide [indiscernible] (00:49:41) because that's where most of the cost is.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And then when you look at the cash generation and you talk about the trajectory that you see going forward for both CapEx and then with free cash flow how are you thinking about deployment sort of post Asco?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

A

Right. So as we look at capital expenditure, we've been historically in the $250 million to $300 million range, this year we popped it up a bit to take advantage of a few different opportunities that were front and center, but as we go forward, it'll go back to a $250 million to $300 million range, but it'll stay at that level for a little while because we still have rate increases and we still have the defense buildup, okay, so that's...

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

..staying at the slightly higher...

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

$250 million to $300 million level.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay.

[indiscernible] (00:50:23)

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

...drop back down we think. Now in terms of capital deployment, we want to make sure we fund all of our productivity initiatives, all of our organic growth initiatives and all of our capital expenditures and we're doing that. Beyond that – our leverage will be at two times by the end of the year, but it will be moving down as we go forward naturally and so we will have some balance sheet capacity, but our goal on capital deployment will be continue with our dividend and gradually increase it over time. And then for free cash flow is if we don't have an acquisition that meets our strategic financial and operational criteria, we will deploy that back to shareholders in the form of share repurchases. So we plan to continue that.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

But on the acquisition side, after Asco, I mean are you actively looking for other things to bring in?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Absolutely. Absolutely. But again, it's got to meet our strategic criteria, Airbus content, military content, fabrication capability has to meet our return thresholds and operationally it has to be a good fit.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

And in terms of scale, is there a sense of what range of size it will be?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

Well, we have a lot of balance sheet flexibility, so we can buy fairly meaningful sized businesses, but again one of our goals is to remain investment grade, so we keep that in mind as well, but a lot of the assets that we're looking at fit well within those criteria.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.
A

But again, we're going to be very discerning as we go forward.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

Then we're talking about sort of Asco-size businesses or ... ?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc. A

We can do it bigger than Asco.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

Okay.

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc. A

But again within the framework of remaining investment grade.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC Q

Okay. I want to ask you the question we've asked every CEO here, which is when you look forward over the next five years, is there a potential disruptive force you see out there, if it occurs that it could pose some risk to the business?

Thomas C. Gentile
President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc. A

Yeah. Well, the thing about the global aviation industry is the one statistic which has been driving it and propelling it is air traffic growth and so traffic has been growing as the middle class becomes more affluent all over the world and it's been growing at a 5% to 7% rate, which means that basically every 15 years air traffic is doubling and that has driven a huge demand for aircraft, it's delivered in unprecedented order book, a record backlog and growing production rates. And so that's all been goodness particularly for somebody in the supply chain like Spirit.

Anything that would disrupt that would be damaging and very disruptive. So, if you think about tariffs that could lead to a trade war, that could decrease the level of global trade or the level of global traffic that would be concerning, anything that could challenge the profitability of the airlines like increasing oil prices or increasing oil interest rates, that would cause them to defer orders or reduce their level of orders, that would also be disruptive. So those are the things that I worry about from a macro standpoint. On a micro level, of course, it's all about making sure we have supply and in parts and that we are meeting our production rates and meeting the requirements for Boeing and Airbus and all of our other customers.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Very good. Well, Tom, thank you very much.

Thomas C. Gentile

President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.

Okay. Thank you, Doug. Appreciate the opportunity.